



## European gas buyers unwilling to pay for security of supply

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Even as we've been going through years of hand-wringing about security of supply, and about how Russia was an unreliable gas supplier, it comes out the European gas buyers are themselves increasingly refusing to pay the price that underpins the security of their Russian supplies, and are breaking their contractual obligations *towards* Gazprom, making Europe, erm, a less reliable customer... something that's likely to come and bite us in the near future:

### [European Energy Firms Fall Short in Gazprom Purchases](#)

European energy companies, faced with weakening demand and plentiful lower-cost fuel supplies, have bought far less natural gas from Russia's OAO Gazprom this year than they are obliged to under long-term contracts -- setting the scene for a potentially damaging showdown with Moscow.

The reason for this is that long term gas supply contracts have their prices linked to that of oil, and the price of oil is now significantly higher than the price for the equivalent volume of gas on the spot markets, thanks mainly to currently very weak demand for gas in Europe, courtesy of the economic crash.

But the whole point of these long term contracts is to guarantee both supply for the buyers, and demand for the sellers. In fact, their very name ("take-or-pay," ie buyers have to pay even if they don't take delivery of the gas) suggests that it is *security of demand* which is the more important of the two. European buyers apparently unwilling that price is a major new development, and a very worrying one.

Of course, they will argue that they are in a competitive market, and cannot let their competitors undercut them with cheap gas procured on the spot market. In the good old days, when they were domestic monopolies, the higher cost of supply could be passed on, in coordination with national authorities, to customers via regulated tariffs, but these don't exist. It is not unreasonable for the now deregulated players that entered into these contracts for national security reasons to be compensated for that effort. But of course there are no mechanisms to do so.

Take-or-pay contracts are a vestige of the early days of the gas industry when liquid spot markets didn't exist and producers needed long-term deals with stable prices to underpin vast investments in new gas fields.

The WSJ article blithely suggests that such long term contracts are no longer necessary, and that

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private markets and spot prices will spur the requisite upfront investment by companies like Gazprom. They might want to take a look at how ExxonMobil, Shell and others developed the Qatari gas industry: on the back of long term take-or-pay contracts for significant portions of the production. Even if Russia were somehow to authorize foreign investment in its gas fields, and exports of that gas by Western oil majors, the contracts would still look very similar to those currently signed with Gazprom.

The issue here is the short term gap between oil-based and gas-based spot prices, which make the Russian (and Algerian, and Norwegian) contracts uncompetitive today. But the European buyers did not complain too loudly when oil price increases in 2002-2008 were passed on to them only with a lag of several months, ie when the differential was in their favor.

So we bump against the intrinsic short termist behavior required of private firms in a deregulated market, which makes a joke of the supposed preoccupations of our governments with security of supply. Long term contracts ARE the best answer to security of supply worries, and they have worked in this industry for 40 years - and they are being trashed by the industry today, because it damages their profits this quarter.

It doesn't seem to matter that we get demonstration after demonstration that deregulated markets do not fulfill the most basic objectives of a sane energy policy (unless you count the profits of energy companies, traders and the banks supporting their speculative endeavors as the only such objectives) - the only lesson our pundits and propagandists "get" from such crises is to call for yet more deregulation.

Go figure.



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